

DOW THEORY LETTERS INC.

RICHARD RUSSELL
P.O. Box 1759
La Jolla, Calif. 92037

36 Letters per Year — \$75 Annually

Registered with the Securities Exchange Commission

August 8, 1973

Letter 571

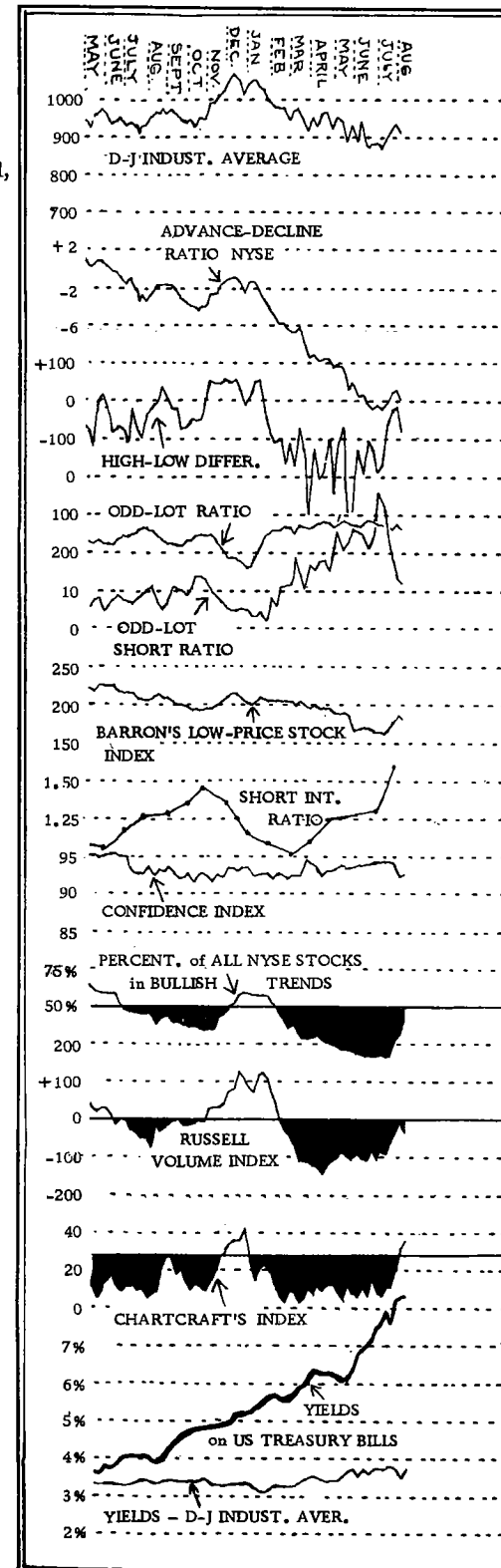
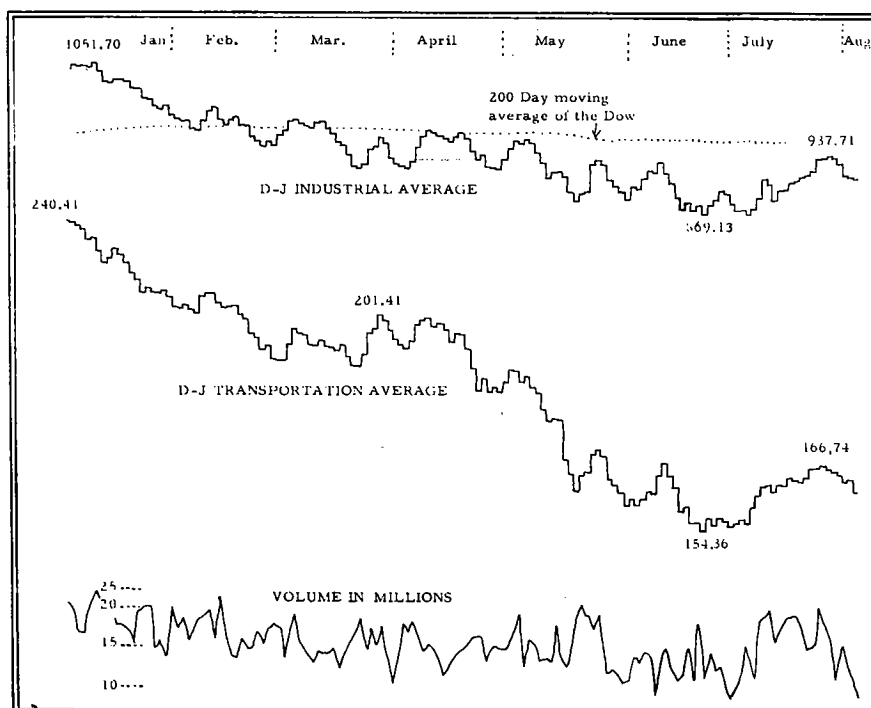
July 27, DJIA 936.71; PTI 726; A-D ratio -12.94

Aug. 3, DJIA 908.87; PTI 688; A-D ratio -14.10

THE MARKET: There is nothing in my studies to suggest that we are not still in the second (and traditionally the longest) phase of this primary bear market. I have noted many times in these reports that the second phase is the most deceptive phase of a bear market. The second phase (which has to do with the psychological background, not the price movement) is the phase wherein the market follows a broad and often irregular path down, all within the framework of deterioration in the social, political and economic background for corporate shares.

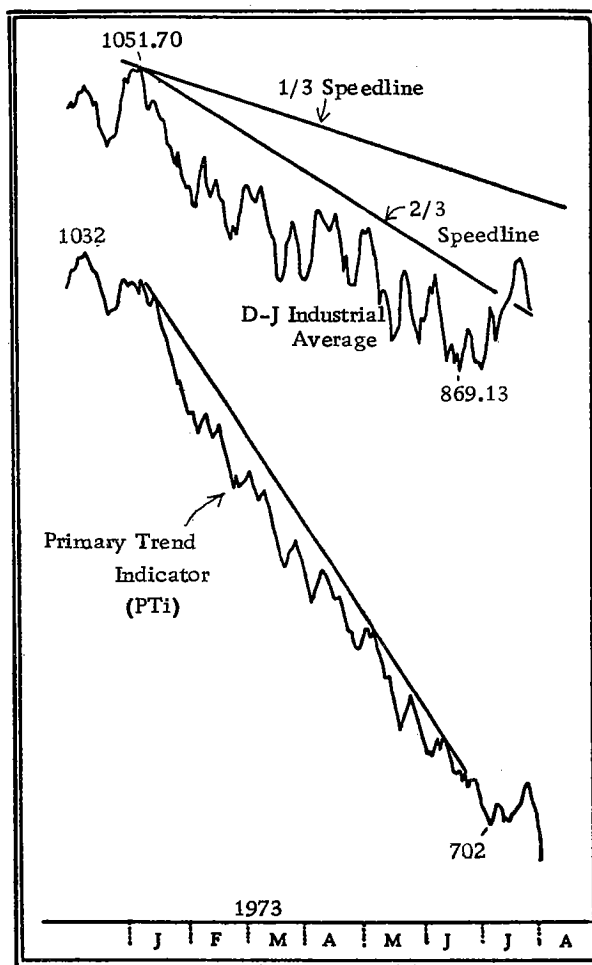
No two bear markets are alike, and certainly many of the events which have punctuated this primary bear market (starting in 1966) have been dramatic, mind-boggling and unprecedented. For the first time in history the US dollar "fell apart" in overseas markets. For the first time in history, the US backed out of a war without winning it. For the first time in modern history, the leadership of the US in the world hierarchy has been open to serious question. And for the first time in many decades, the US appears to be in the position of facing multiple crises with almost no visible Administration "in charge."

Personally, I dislike being bearish. Furthermore, there is nothing more frustrating and destructive than a bear market during a period of inflation. For instance, over the past few years almost everyone has had a perfect opportunity to lose their money (instead of money I should say "buying power," since many people feel that our "money" is already lost). Savings, insurance policies, cash, bonds, all have been decimated by the forces of inflation. To add insult to injury, the majority of stocks since early 1972 (actually many since early 1971) have gone down. True, there have been pockets of great appreciation such as art, real estate, houses, coins, stamps, antique guns, and commodities and farm products. But on the whole, the average American has been knocked silly by the twin forces of inflation and tumbling stock prices.



Page 2 Starting from the all-time peak of 1051.70 of January 11, 1973, the Dow dropped to a 1973 low of 869.13 (June 25). On the same day the Transports hit a 1973 low of 154.36 (down from their December 11, 1972, peak of 240.41). I am not going to go over the horrendous battering which the rest of the market suffered during that period, but it is well to note that since the end of June, many of the technical indicators turned intermediate-term bullish. In the last Letter I stated that "...the odds on a secondary (but important) bottom having been seen during late-June and early-July are at least 50/50." I received a number of letters asking why "only a 50/50 possibility?" I referred those subscribers to the second section of the last Letter in which I pointed to the "fly in the ointment," the monetary picture. This was the reason I presented the last Letter in two parts: (1) the improved (technical) market situation, and (2) the ominous background as provided by the money market.

In a bear market rally such as the one in effect from June 25 to July 27 (we don't yet know whether it is over), it is crucial to scrutinize the entire technical picture as it unfolds. Bear market rallies often look "better" than rallies in bull markets simply because bear rallies tend to be "unexpected," violent, and extremely rapid in nature. Bear rallies (like bull rallies) nevertheless must materialize from somewhere, and in the last report I reviewed all the page 1 Composite Chart indicators, concluding that almost all of them appeared positive except for the last two, namely T-bill yields and the DJIA yields.



For bold traders who were willing to accept a possible loss (if need be) in an effort to scalp a bear market rally, I suggested only no-load funds as the trading vehicle. Here there is no commission to pay, and a no-load fund has the added potential of being able to capture an upside move in breadth (since most funds are literally a cross-section of the market). And with no commission, I find that the average trader is more willing to take his loss and run if subsequent events prove him wrong. He who accepts a quick trading loss and runs away, lives to trade another day. Remember, a trading loss represents the cost of "insurance" against getting caught in a major collapse.

Since the last report a number of technical factors have emerged which warrant careful study. First I should mention the bullishness among the advisory services. Never have I seen so many services turn so uniformly bullish on the market. I must admit that even with my conservative "50/50" bullish indication, I felt uneasy being among so much bullish advisory company. "Major bull signal" reports are still coming in to this office from as far away as Europe. All of which makes me wonder whether this market is going to oblige — even with a substantial secondary rally.

Another of last week's developments served to raise serious questions in my mind regarding the probability of a full upward correction at this time (see PTI chart). On July 27 Industrials stood at a recovery peak of 936.71, Transports at 166.74. With money rates going through the roof the stock market turned abruptly down under the lead of Utilities and Bonds (see last Letter). On August 1 my Primary Trend Indicator (PTI) broke to a new bear market low, and on August 2 it again dived. In the six days between July 27 and August 2 the PTI lost an unprecedented 42 points (see chart).

Since the last Letter (#570) used the trendline reversal and upward zig-zag in the PTI as the leading technical indicator calling for a potential upward correction, the new August lows on the PTI cancel out these indications. Furthermore, if the Dow turns around and rallies to new highs for this move (above 936.71), the PTI (which has now broken so badly) is almost guaranteed not to confirm. Thus the current technical picture looks decidedly darker than it did at the time of the last report.

I am including the updated Monetary Chart (page 3) and here we see that the monetary background, too, appears worse than it did 10 days ago. The Utility and 40-Bond Averages have declined substantially further (with Utilities breaking 100 on July 1, the first time they have been under 100 since the 1970 crash lows). Veteran subscribers know that a joint downtrend in the two money-sensitive Utility and Bond Averages spells "negative" for the stock market. Incidentally, the 1970 low for the Utility Average was 95.86. If Utilities break below the 1970 low, I think the market could become totally rattled, in which case it would not surprise me to see panic conditions take over!

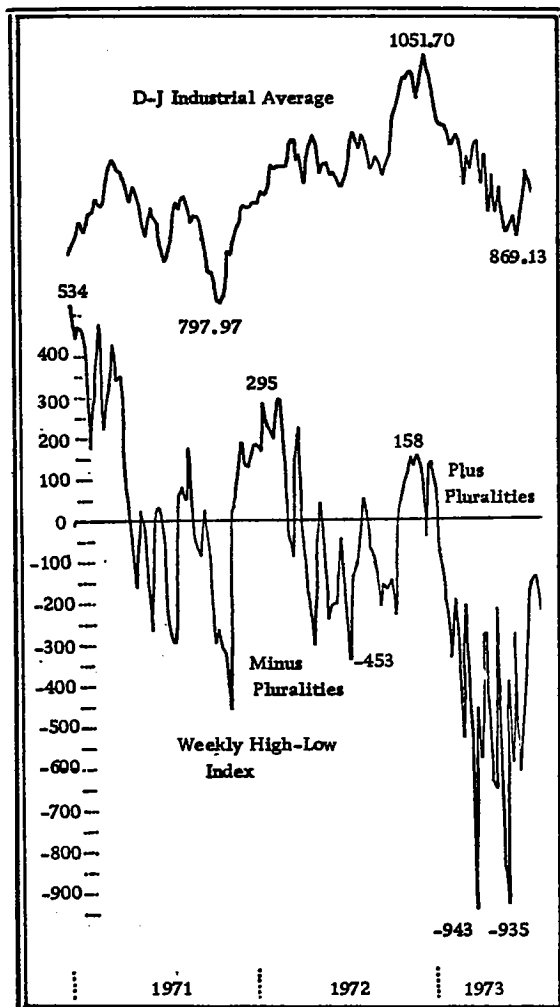
Subscribers seem fascinated with "Will Go," so named because whichever way this indicator points, the market will go. Will Go is made up as follows: the differential between the yield on the Dow and the yield on Barron's 10 Hi-Grade Bonds is computed, then compared with that differential five weeks before. The difference between the current and the 5-weeks ago figures is then added (or subtracted) to a running total (like an advance-decline total). This figure is then plotted 10 weeks into the future.

At any rate, Will Go, our predictive monetary indicator, is now saying trouble towards late August and carrying into at least mid-October (which is as far as it is now pointing). It is conceivable that the fantastic recent tightening of money has pushed Will Go's timetable for a market top forward a bit, but that remains to be seen.

Finally, the Aaa Bond/T-Bill yield ratio (with 91-day T-Bills at record high yields of 8.4% and with Aaa-rated Bonds at 7.4% yields) is still saying, as it has since March, that a credit crunch is here. Anytime this ratio sinks under 1.2, it represents a bearish reading for the stock market. Any time the index is below 1.0, it is saying "crunch-time" for the money markets.

Next, I am including a very basic technical indicator which deserves attention at this time. It is the index made up of the weekly plurality of new highs and new lows on the NYSE. The accompanying chart shows these actual weekly pluralities (no moving average is used), and here we can see the steady deterioration which began in early 1971.

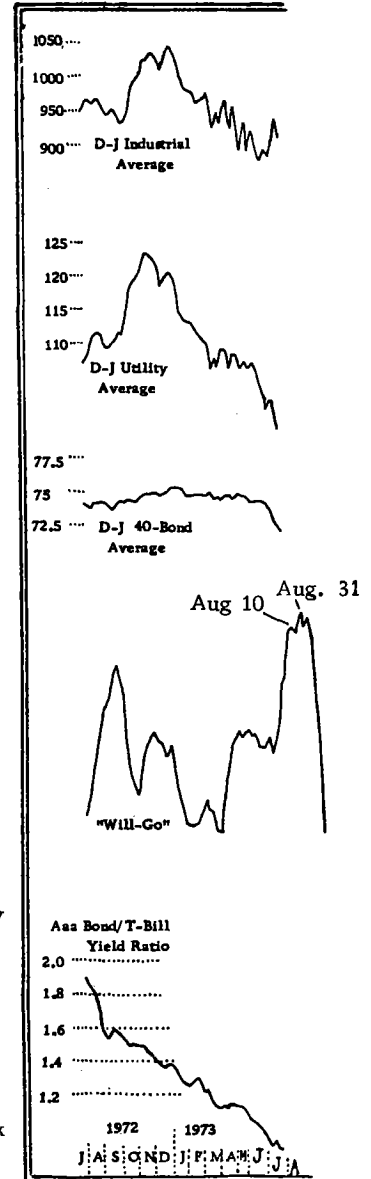
Note the series of successive lower tops, the plus 534 of January 22, 1971, the plus 295 of March 3, 1972, and the plus 158 of December 8, 1972. Each of these descending pluralities



was accompanied by rising peaks in the Dow, a sign of underlying weakness. Against this on the downside we have the minus 453 of November 26, 1971 (with the Dow at 797.97). Then comes the minus 943 of the week of March 27, 1973, with the Dow at 923. Finally, we see the minus 935 of May 25, 1973, but note here that with the Dow lower the May pluralities were not as bad as the earlier March pluralities.

Following May 25, 1973, despite another month of falling prices in the Dow, the high-low pluralities improved dramatically. On the week of July 27 the pluralities contracted to minus 87, the first time they have been under minus 100 since January of this year. Last week (week ending August 3) the high-low index recorded a minus 235. A setback, and we should note at this time that the high-low index (while looking better than at any time in 1973) has so far failed to move into plus territory. The trend of this index portrays ebbing weakness, but it does not yet indicate gathering strength (as a series of rising pluses would)!

It should be remembered that in a primary bear market, strong selling pressures can give way to very mild selling pressures — and then to strong selling pressures again! This is the basic danger of playing for an upside correction in a bear market. And it is the reason why I have always been cautious about suggesting that subscribers jump in on a rally during a bear market.



Page 4 Bear market rallies can be spectacular and profits can mount amazingly quick. But don't ever forget that when you make a mistake in a bear market you do not have the underlying primary trend to bail you out. When you make a mistake in a primary bull market, however, you are more often than not bailed out by the passage of time.

SUNDRY NOTES & QUOTES: From all directions (as predicted in the last Letter) record high interest rates are driving bonds, utilities and interest-bearing paper through the floor. Yields are becoming "fabulous" by past standards. But is there something wrong with the picture? Is this what is wrong — is 8.5% interest on a piece of depreciating paper just 8.5% of a bad dream? Are the current "fat yields" going to look unattractive before this monetary crisis is over? That unpleasant thought occurs to me.

Could this be the script (see Tehan's comments later on): US interest rates run through the roof as the Fed clamps down on the money supply. The dollar rises against foreign currencies and the whole world finds itself holding paper moneys that are bobbing around like apples in a bathtub. Suddenly, the rush for real value (gold and silver) is on as world economies go into recession. Then, as the world recession deepens, the various nations bring down interest rates via inflation and relaxation of bank rates. Gold and silver (in response to the new inflation) go through the roof.

* * *

From leading bond expert Henry Kaufman (Saloman Bros., July 27 "Comments on Credit")... "With each passing week conditions in the money market have been deteriorating, and the task of monetary restraint has become increasingly arduous and at times, alarming. At a minimum, a financial tremor seems in the offing further efforts by the Fed to slow the availability of credit is likely to produce additional spectacular increases in money rates in the weeks immediately ahead." (My note: Mr. Kaufman is not noted for exaggerated statements).

* * *

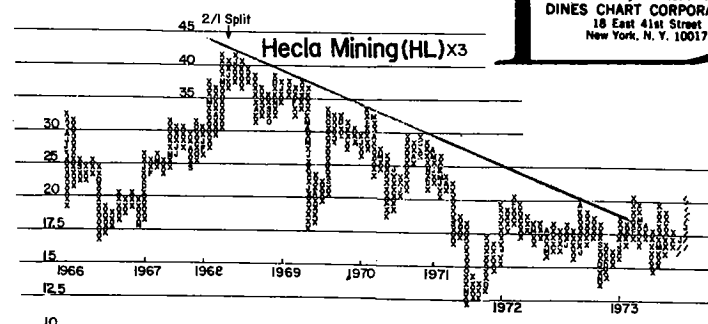
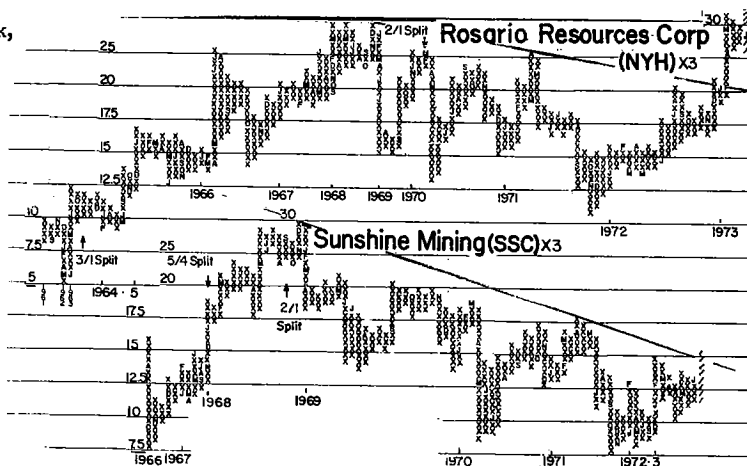
My friend E. George Schaefer (910 E. 38th St., Indianapolis, IN 46205) has been much more of a silver-bug than I have. In his July 28 report, this famous Dow Theorist says, "I say, put 100% of your money into gold and silver, and keep only enough cash to live on." Schaefer has been growing more and more bearish on the future of the dollar and increasingly certain that inflation is going to run its dreadful course.

As far as silvers are concerned, I have made a number of silver recommendations in the past, and the fact is that the silver shares now seem to be coming to life. I have included here a few charts from Jim Dines' Pafflbe P & F chart book, and as we can see, the bases in many silver stocks are large enough to support major upward moves. Famed monetary expert Franz Pick thinks silver could go to \$8 to \$12 within two years. To which I can only say, "Hide the forks and spoons!" What do I think of silver, "the poor man's gold?" I am inclined to think Schaefer is going to be right. Silver is moving into short supply, and although silver is not a monetary metal, it is a precious metal, and my chart shows that silver metal is tending to keep up with gold (percentagewise) on the upside.

Incidentally, subscribers who followed my advice in Letter 532 in which I presented a two-page recommendation on the Sunshine Mine convertible bonds have done exceedingly well. The bonds have risen from the 78-80 area to the current 98-99 area, thus appreciating 25% while providing a yield of 8%. And 25% appreciation plus an annual 8% since June, 1972, isn't bad during one of the messiest market in years.

* * *

In his July 17 address to the NY Society of Security Analysts, the brilliant William Tehan (of P.R. Herzig & Co.) said that the final stage of a chronic balance-of-payments deficit is when "all currencies become



Reprinted from
THE CROSSCHART BOOK
A Monthly Publication of
DINES CHART CORPORATION
18 East 41st Street
New York, N. Y. 10017

inflated" following which "capital then begins to move to gold as the ultimate store of value." This is what has happened since 1970, observed Tehan. In the past three years foreign central banks have seen their dollar balances rise from \$7 to \$60 billion. These dollar "reserves" constitute 90% of the monetary assets of foreign central banks — but against this \$60 billion the US has only \$10 billion in gold. In other words, a huge amount of foreign reserves are inconvertible. "For the first time in history," said Tehan, "not only are the world commercial banks illiquid but the central banks are illiquid."

Tehan stated that since the value of a currency is determined by the liquidity of the issuing central bank, all currencies can now be considered "seriously inflated." This creates instability, and with this comes the failure of the currency to perform its store of value function. Tehan sees rising US interest rates as the precursor of general weakness in all the other currencies (which have been strong against the dollar). Finally, this will leave "...gold bullion as the only unit in the currency world which is liquid and stable." At the wind-up of the crisis, Tehan (brace yourself) sees "a 90-day T-Bill rate between 10% and 15%, a Federal Funds rate at 100%, a free market price of gold bullion between \$500 - \$1000 per ounce and a crisis in the banking system." (For some reason, very little of Tehan's speech was reported in the financial or any other press!).

"Nixon fiddles while Arthur Burns," so said the wags a few months ago. No so now. On July 3 Fed Chairman Burns stated that he wants a continued money squeeze and a \$10 billion tax increase. My bet (with Mr. Nixon hog-tied by electronic tape) is that Mr. Burns will get the tight money but never the tax rise. But the first will be enough to throttle Wall Street.

Big John Connally, our last Treasury Secretary, has left his job of protecting the dollar and he has also left Washington. Now I assume he can tell it like it is, and I reprint this excerpt from a recent speech that Connally gave (the clip comes from, of all places, the London Mining Journal):

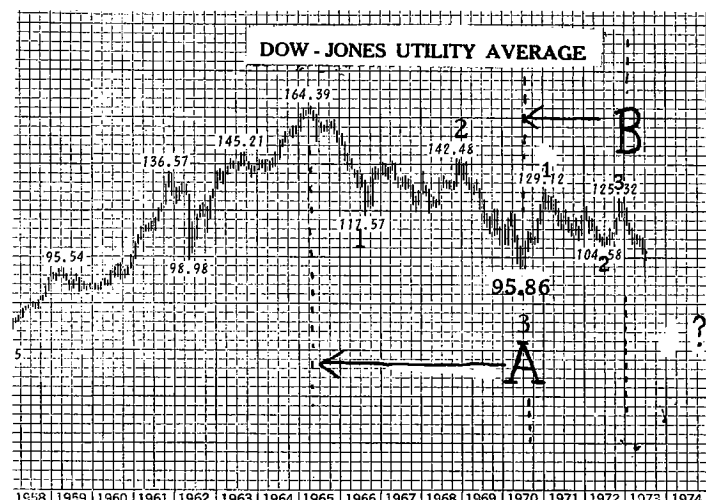
On August 4 the prime rate went to a record 9%, but you could hardly hear the new record highs in interest rates above the roar of the monetary printing presses. For instance, on August 3 reserve requirements for savings and loans were lowered, thus boosting green paper available for mortgages up \$2.2 billion. New highs in the nation's money supply continue to be reported weekly.

CHART OF THE MONTH: The accompanying chart may be telling the most important story of the year. Here we see a monthly chart of the Utility Average with the 1970 closing low of 95.86 labeled (chart courtesy of Horsey, Salisbury, MD 21801). Those who studied my recent Elliot Wave pieces know that major bear markets take the form of an A leg down, a B leg correction (upward) and a final C leg down. Try as I might, I cannot show the 1970 low as the completion of a Utility bear market under Elliot. I see the 1965 to 1970 smash as bear market leg A for Utilities. The action since 1970 is part or all of corrective leg B, which was probably completed in late-1972.

The action of 1973 is probably the beginning of the major leg C down, and if Utilities crack 95.86 I will be fairly certain of this depressing fact. Therefore, if 95.86 is broken on the Utility Average, it will be a most ominous sign suggesting that the predictive Utility Average is leading the way for Wall Street and the nation. If so, that information should be worth the price of a subscription to this advisory ten times over.

The latest (August) issue of the Bank Credit Analyst (Editor, Donald Storey) contains a major and most excellent article on gold. Storey puts forth many comments and conclusions; here are a few. (1) It is possible that inflation could soften temporarily; the long-term trend of monetary and price inflation is sharply up. "Countries are simply not prepared to accept the deflation of incomes necessary to stop inflation. Incomes, ultimately, can only be deflated by ceasing to print money, a thing no central bank will undertake for more than a few months." (2) In the end, the world will have to have monetary reform. ADR's and other paper "reserves" will not work in such reforms, because you cannot back paper with more paper. Furthermore, ADR's will always be less acceptable than gold because they will be printed in excess and there will be no private market for them. (3) Any real reform

On the general question of reform, a recent speech by John Connally (formerly Secretary of the Treasury in Washington) to the Wharton Graduate School Alumni Club in New York is particularly relevant. Speaking essentially to an American audience he commented that "the era of American supremacy in international finance that began in World War Two is finished. The monetary and trading system that provided the basis for the post war era has collapsed. There is no point in kidding ourselves about it, that it is just shaky, that we will reconstruct it". He continued, "during the decade of the 1960s American dollars overseas increased by a ratio of six to one over our gold reserve. It was pure fiction that the dollar was convertible into gold. We had simply expended our surplus and extended our credits until both were exhausted. The American illusion of invulnerability was clearly an illusion and it was demonstrated again that no nation is so large and so powerful that it is invulnerable to change".



will be bullish for gold, since it must entail a gold base with gold at a much higher price. (4) The US balance-of-payments and trade deficit are being reduced, and this together with rising interest rates could be short-term bearish for gold and gold shares. (5) Forthcoming weakness in gold should be used as an accumulation time for gold shares. (6) The longer monetary reform is put off, the higher the ultimate price for gold will have to be. (7) Storey feels that "while \$100 an ounce for gold was plausible 5 years ago, \$120-130 is clearly insufficient now. A figure of at least \$200 would probably be required now, and should world commodity prices continue to rise and confidence slide, this figure would obviously be inadequate."

LATE NOTES: The battle grounds are drawn from the Dow Theory standpoint. "All clear" would entail a joint (Industrials and Transports) bettering of the July 27 peaks of 936.71 and 166.74. Resumption of the bear market would be confirmed by a breaking of the 1973 lows of 869.13 and 154.36. The market has acted poorly since the July peaks, and the PTI has taken a spectacular plunge.

The "most-active stocks" index, having turned plus on July 18, stayed on the plus side for 11 consecutive days before again dropping (August 2) into minus territory (see Letter 567, page 3). The MAS index has been a good leading market index all during 1973, and it is once more looking bearish.

With the dollar currently rallying, it would seem that at least one pressure is being removed from the interest rate spiral. Yet the market acts as if it has already discounted an improving dollar. It's a very nervous and ticklish situation with the market not acting nearly as well as the bulls and even the trading optimists might have expected. If the next rally fails to look impressive (and the way things are going I'd be surprised if it does), I would suggest that any subscribers who took on trading commitments give them back if you have not already done so.

My feeling now is that in view of the above and in view of the dismal profile of Will Go as seen on page 3, the odds are much better than even that the July 27 peaks will not be bettered by both Averages (during any forthcoming rally), and that the primary bear market is ready to resume.

GOLDS: Spectacular spreads are developing between the London price of S. African gold shares and the dollar price of ADR's. These spreads are shown on these charts by Kaffir Chart Service, Palisades Pk, NJ 07650. I can only conclude that American traders run at every rumor whereas the more sophisticated overseas holders do not throw gold shares in everytime Secretary Shultz says "Boo!"

Patience, as usual, will have to be exercised by all of us who hold the golds. This is one of those years in which stocks get slaughtered, bonds are smashed, the value of dollar savings erodes and here (in mid-summer) even the golds correct. As I have said before, primary bear markets are periods in which we try to survive, not get rich.

